REFINING NZ

Your Energy Hive

Half Year Announcement

2014

The New Zealand Refining Company Limited
Results for announcement to the market

Reporting Period six months to 30 June 2014
Previous Reporting Period six months to 30 June 2013

The Directors of the New Zealand Refining Company Limited today announced the Company's financial results for the six months to 30 June 2014, details of which are attached.

This report, including the results for the previous corresponding year, is consistent with the unaudited interim financial statements of the New Zealand Refining Company Limited for the six months ended 30 June 2014.

Consolidated Results

1. Results $NZ 000

Revenue from ordinary activities.
Current year $92,436
Down 27%
Previous corresponding year $126,467

Profit from ordinary activities after tax attributable to security holder.
Current year $(6,964)[1]
Down 233%
Previous corresponding year $5,228

Net profit attributable to security holders.
Current year $(6,964)
Down 233%
Previous corresponding year $5,228

[1] ( ) = denotes loss

2. Interim Dividend
The Directors have resolved not to pay an interim dividend.

3. Net Tangible Assets per Security
As at 30 June 2014 $2.04
As at 30 June 2013 $2.13

COMMENTARY

Refining NZ has weathered a difficult start to the year caused by weakening refiners' margins and a strong New Zealand dollar, to report an interim net loss after tax of $6.9 million for the six months ended 30 June 2014, a turnaround from the net profit reported a year ago (2013: $5.2 million).

Chairman of the Northland based refiner, David Jackson said the result was to be expected given the harsh business environment, but also reflected the robustness of the processing arrangements the Company has with its oil company customers.

"By far the biggest impacts on the Company's processing fee in the first half have been the weakening of refiners' margins, brought about by a marked decline of the benchmark Singapore refiners' margin, and the high exchange rate.

"During the period, the Company maintained an uplift over the Singapore margin and further cushioned the impact of weak margins on our processing fee income by replacing catalyst, implementing margin improvements on the hydrocracker, and drawing on the fee floor via the processing arrangements with our customers."

"The floor mechanism recognises the criticality of the refinery to our customers and to the New Zealand fuels supply chain. It is an entirely unique arrangement for the refining sector and was agreed with our customers to counter exactly the conditions the Company has experienced over the last six months," he said.

Jackson commented that during numerous visits to Marsden Point he had been impressed by the positive attitude of the staff and contractors and their continued resilience in what had proved to be trying circumstances since the beginning of the year.

KEY PERFORMANCE HIGHLIGHTS

- Refining NZ remains on track to achieve a structural uplift in the Company's Gross Refining Margin (GRM) of USD 0.66 per barrel from a series of technical and other improvements on the refinery's hydrocracker unit.

- The Company has strengthened its balance sheet to counter the weakening margin environment, extending bank borrowing facilities by $150 million and adding $54 million of capital raised from institutions and individual investors.

- A rigorous focus on cost management sees the Company on track to exceed targeted cost reductions of $7 million, with a further $6 million over the remainder of the year.

- The $365 million Te Mahi Hou project (TMH) is progressing to plan, with all key TMH units delivered, civil and mechanical work (e.g. pipe fabrication) well advanced. To date $240 million has been invested in this key project.

- A new Customer Value Proposition involving the refinery in selecting crude, has been taken up by two of its oil company customers and is reaping benefits for all parties to the agreement.

- $40 million is to be invested in a CO_2 purification plant at the refinery by gases company BOC, as part of an agreement to supply CO_2. The agreement creates an additional revenue stream independent of refining margins and the exchange rate.

BUSINESS ENVIRONMENT

The further weakening of Singapore refiners' margins contributed to the Gross Refiners' Margin (GRM) generated in the first half of the year averaging USD 1.66 a barrel (2013: USD 5.27).

Said Jackson: "Singapore complex margins have weakened during the period, showing unseasonal weakness in May/June to average USD 0.10 per barrel."

"The planned shutdown of the hydrocracker limited the Company's ability to upgrade low-value residue to higher value products, and negatively impacted processing fee income. Coupled with the decline in Singapore complex margins, the Company invoked the fee floor in the processing arrangements with its customers, with a total pro rata of $36 million paid in the first six months."

"With the exception of the shutdown, the Company maintained its margin uplift over the Singapore benchmark during the period. This was at the typical range of USD 3 to 4 per barrel in May/June and is expected to widen in July/August to around USD 7 per barrel, on the back of the impact of the hydrocracker initiatives, crude marker differentials, and de-stocking of residue."

Jackson said actions by global refiners to counter the fall off in demand growth for oil products, brought on by slower than expected economic growth forecasts for China and sluggish growth in Europe, are likely to have a positive impact.

"Overcapacity continues to impact margins, but global refiners are tackling the issue rationally, with ongoing closures, run cuts and the postponement of investment in capacity upgrades, notably, by two of Korea's largest refiners as well as Chinese refiners and their international partners. This presents the possibility of a modest improvement in refiner's margins over the second half of 2014."

"The Company result has also been influenced by the strong New Zealand dollar. In the first six months of the year the rate averaged USD 0.84 (2013: USD 0.82) and negatively impacted processing fee revenue. While the NZ dollar coming off its peak of USD 0.87 is welcome, we expect to see foreign exchange volatility for the foreseeable future," he said.

STRATEGIC ACTION PLAN

The Company's strategic plan of action, focused on managing the Company's cost base, and generating more of the high-value products from the same barrel of crude oil continues to gain traction.

Chief Executive, Sjoerd Post confirmed that the Company was on track to reduce costs by $13 million, which amounted to an over delivery of $6 million for the year.

“Early impetus has come from cementing-in the substantial savings from renegotiating electricity and natural gas supply contracts, and changing contractor arrangements, including introducing ten hour working days.

“Added to this, modern procurement practices are showing-up further savings while the establishment of strategic alliances is bringing better ways of working with key suppliers. The Company has completed over 80 procurement actions, all of which is contributing positively to our performance,” he said.

In July, the Company announced the results of the margin improvement initiatives on the hydrocracker unit – including the replacement of hydrocracker catalyst; the revamp of the Vacuum Distillation column; installation of the MVC bleed line to the BDU; as well as a record use of natural gas in the refinery.

“Results show that the combined margin improvement from each initiative is tracking in line with the forecast USD 0.66 per barrel margin uplift announced to the market in February.”

Added Post: “As the margin environment improves these initiatives will have an even greater positive impact on our margins. By our reckoning, the uplift we are seeing in July-August margins means the combined effect of these margin improvements is likely to add around USD0.90 per barrel to our margin over that period – with an increased use of natural gas playing a significant part in that expected uplift.”

In February the Company launched a new Customer Value Proposition in response to ultra-competitive pricing from Asia Pacific refiners. Post confirmed that the Company’s new role, selecting crude for two of its customers, is reaping benefit from reduced cargo costs and the efficient sequencing of crude deliveries to the refinery.

“We know that Korean discounting has given our customers more supply choices, but with this new CVP we have a compelling reason for our customers to continue to make product at Refining NZ – based on continuing to produce high quality “on spec” products; relentless focus on reliability proven by world class rates of unplanned downtime; and being competitive on price.”

TE MAHI HOU (TMH)

TMH which is due for completion late 2015, is progressing to schedule and budget.

“Construction activity on the project has ‘ramped-up’ with all key TMH units delivered to the refinery, and civil and mechanical work (e.g. pipe fabrication) well advanced. The next milestone comes in the first week of October when the project team begins lifting TMH components into position and starts assembling these on site.”

“Earlier in the month the project team reached one million hours without a lost time injury which is a credit to everyone involved, especially given the number of people on site and the volume of work being undertaken at any one time,” he said.

TMH is expected to generate operating cash flows of around $60 million, a structural uplift in processing fee revenue of around $70 million per annum and increase margin by around USD 1.10 per barrel. To date the Company has invested $240 million on this key project.

Looking ahead, Post said the Company continues to tap into the expertise of the refinery's talented workforce, promising that there is further opportunity for the Company to lift performance from a "funnel" of home-grown initiatives under development.

RELIABILITY AND PLANT PERFORMANCE

In March the Company carried out a planned maintenance shutdown on the hydrocracker and related units. A combination of bad weather, emergent repairs and the failure of a compressor during start-up added 16 days to the shutdown schedule.

Said Jackson: "We continued to manufacture via processing units not included in the shutdown, and by bringing processing units online after completed planned maintenance. This proved critical to assisting our customers manage country fuel stocks, particularly jet fuel for the aviation industry. Overall, a good operational performance during this period and the sale of excess hydrocracker feed at a higher than anticipated valuation, meant the Company was able to limit the financial impact of the extra shutdown days to a one-off impact on processing fee revenue of around $10 million."

"The extra shutdown days were a disappointment, particularly for our maintenance and operations teams who worked continuously to bring the impacted units back into operation, and for our customers with whom we worked closely to minimise the impact of the delay on their respective businesses."

"On the upside, the shutdown was an opportunity to replace catalyst and carry out a number of technical improvements on the Hydrocracker unit. These improvements have been successfully implemented and are showing positive early results."

Jackson confirmed that the Company is also planning a maintenance 'pit stop' for a preventative fix on a compressor in the coming months.

DEFINED BENEFIT SCHEME REVIEW

Following a review of the defined benefit scheme in 2013, the Company had offered pensioners more options - including the option to cash up part of their benefit entitlement, based on actuarial assessment of the value for each individual member.

"To date around 40% of the scheme's pensioners have taken up the offer, which has decreased the schemes' balance sheet liabilities by around $7 million. Over the longer term this means the Company's exposure to scheme volatility is reduced. The Company is close to having an offer for staff members early next year."

INDEPENDENT DIRECTORS REVIEW OF THE PROCESSING ARRANGEMENTS

"As part of the annual review of the processing arrangements with management, the Independent Directors have determined that an external review of the arrangements will be conducted by independent industry consultants, Hale and Twomey. A full report will be made available to shareholders later in the year once the review has been completed."

SHAREHOLDER RETURNS AND DIRECTOR FEES

Given the loss making result for the six months ended June 30, 2014, the Directors have resolved not to pay an interim dividend to shareholders.

Referring to Directors fees for 2014, David Jackson confirmed that the Directors have agreed that where a shareholder is represented by two Directors on the Board, with immediate effect, the fee for the second Director will be waived.

FUTURE OUTLOOK

"The Company is lifting its performance by sticking to its strategic plan of action and having the support of the robust processing arrangements. As a result, the Directors have every confidence that the Company will prove itself capable of weathering the business environment in the latter part of the year," Jackson said.

The Company has issued a revised profit matrix based on the June 30, 2014 result and the outlook for the remainder of the year.

ENDS

Notes to editors:

Processing Fee Floor. This is the minimum Processing Fee due, for a calendar year, up to a maximum of NZD 126 million for 2014.

If the year-to-date Processing Fee is below the pro-rata Fee Floor, then an interim pro-rata Fee Floor payment is made by the Customers. Should the Processing Fee exceed the Fee Floor in future months any pro-rata Fee Floor payments that have been made, are repaid to the customers.

Te Mahi Hou (TMH). The expected benefits from the TMH project are based on the investment case outlined in the 2012 Notice of Annual Meeting explanatory note, available at www.refiningnz.com

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